Budget Overview
- An Executive Summary -

BUDGET PROCESS – A PRIMER

This section provides an overview of the basic budget concepts, definitions of budget terms, and background and reference information pertinent to the 2011 biennium budget and legislative appropriations process. For more in-depth information, see "Understanding State Finances and the Budgeting Process", available through the Legislative Fiscal Division.

Types Of Legislative Appropriations

Article VIII, Section 14, of the Montana Constitution reads:

"Prohibited Payments: Except for interest on the public debt, no money shall be paid out of the treasury unless upon an appropriation made by law and a warrant drawn by the proper officer in pursuance thereof."

Appropriations power lies with the legislature. In 17-7-501, MCA, three types of appropriations fall within the meanings of "appropriation made by law" as used in Article VIII, Section 14, of the Montana Constitution.

<u>Temporary appropriations</u> – Most activities of state government are funded on a temporary basis, usually for two-year periods. Funding, therefore, must be reauthorized by each legislature. The main vehicle for the provision of temporary appropriations is HB 2 (the General Appropriations Act).

<u>Statutory appropriations</u> – Statutory appropriations are made directly in statute, and are automatically made until and unless the law is changed. Statutory appropriations are listed in 17-7-502, MCA.

<u>Budget amendments</u> – Various authorities (most often the Governor) can approve the addition of certain funds (primarily federal) during the interim if certain statutorily defined conditions are met. General fund appropriations cannot be added without express legislative approval.

In limited cases, authorizations to expend funds can also be made through appropriation or under general laws and contracts. The great majority of state agency operations are funded through temporary appropriations.

Fund Types

Governmental accounting differs from private enterprise accounting in that funding is segregated and defined by the source and use of the funding. There are four main groups of funds in state government accounting.

- Governmental funds consist of the following funds:
  - General fund includes all financial resources except those that must be accounted for in another fund. The general fund collects most general taxes levied, including individual and corporate income tax, property tax, and investment income. Revenue from a number of other taxes is also deposited into the general fund.
  - Special revenue funds consist primarily of two funds: 1) State special revenue is money from state and other sources earmarked for the purpose of defraying particular costs of an agency, program, or function. The largest state special revenue accounts are the Highways State Special Revenue Account (HSSRA), which collects various fuel taxes and is used to support highway-related functions; and 2) the general license account, which collects various hunting and fishing fees and is used to support functions in the Department of Fish, Wildlife, and Parks.
  - Federal special revenue is revenue from federal sources. Most state agencies receive some federal funds. The two major sources of federal funds are used to support highway-related functions and human services programs such as Medicaid. This fund also accounts for trust activity formerly defined as expendable trusts.
  - Debt service funds are used to account for the accumulation of resources for the payment of general long-term obligations, including principal and interest. Debt service funds are statutorily appropriated.
  - Capital projects funds are financial resources used for the acquisition or construction of major fixed assets. These funds are appropriated through bills that fund capital projects.
  - Permanent funds account for resources that are restricted to the extent that only earnings and not principal may be expended for purposes that support state programs. These resources were formerly classified as non-expendable trusts (i.e. the coal tax trust).
- Proprietary funds are used for operations that provide goods or services to the public on a user-charge basis (enterprise funds), or to other agencies or programs of state government (internal service funds).
- Fiduciary funds provide for those assets held by state government in a trustee capacity, or as an agency for individuals, private organizations, other governmental entities, or other funds.
- University funds are used to support the university system and are classified according to the College and University Business Association (CUBA) structure.

The legislature appropriates a portion of the funds used to support the university system as governmental funds, which are then reclassified as university system funds.

With the exception of a small portion of proprietary funds, the legislature does not directly appropriate proprietary, fiduciary, or university funds. The legislature directly appropriates most governmental funds. Debt service funds are usually statutorily appropriated. Capital projects funds are appropriated in the bills that fund the capital projects. The great majority of general fund monies and special revenue funds are appropriated through temporary appropriations bills.

HB 2

The temporary spending bill through which the vast majority of general fund monies and special revenue funds are appropriated is HB 2, the General Appropriations Act. The budget analysis contained in Volumes 3 through 7 of the Legislative Fiscal Division Legislative Budget Analysis concentrates on the appropriations proposed for inclusion in HB 2.

Statute requires that the legislature establish fees and charges for all internal services functions. Statute further restricts programs from increasing those fees and charges during the biennium. The executive budget must also include a rate analysis of enterprise funds and internal service fees and charges. While only a small portion of proprietary funds are appropriated in HB 2, all rates approved by the legislature are listed in that bill.

Figure 1 shows all internal services rates reviewed and approved by the legislature.

Figure 1

Internal Service Functions
2011 Biennium

Agency/Program or Function
Transportation
Motor Pool
Equipment
Revenue
Customer Service Center
Administration
Director's Office
Management Services Unit
State Accounting Division
SABHRS Services
Audit Review
Warrant Writer
General Services Division
Facilities Management
Mail Services
Print Services
Central Stores
Statewide Fueling Network
Surplus Property
Information Technology Services Division
Health Care and Benefits Division
Workers Compensation Management
Human Resources Division
Professional Development
Human Resources Information System
Risk Management and Tort Defense
Fish, Wildlife, and Parks
Vehicle Account
Aircraft Per Hour
Duplicating/Binding
Warehouse Overhead
Environmental Quality
Central Management
Natural Resources and Conservation
Air Operations
Commerce
Board of Investments
Director's Office/Management Services
Justice
Agency Legal Services
Corrections
Moror Vehicle Maintenance
Cook/Chill
Laundry
Labor and Industry
Centralized Services
Business Standards
Office of Public Instruction
Indirect Cost Pool

Budget Terms

Budgets must, by statute, be submitted in three tiers to allow legislative scrutiny of all stages of budget development:

<u>The base</u> - defined as the resources for the operation of state government, and used to cover current biennium expenses of an ongoing and non-extraordinary nature. The base and how it is derived are discussed in more detail in the “Base Budget” portion of this narrative.

<u>Present law</u> - defined as that additional level of funding needed to maintain operations and services at the level authorized by the previous legislature. Present law includes but is not limited to legally-mandated workload, caseload, or enrollment changes, changes in funding requirements, inflationary or deflationary adjustments, and elimination of one-time appropriations.

<u>New proposals</u> - defined as requests to provide new non-mandated services, to change program services, to eliminate existing services, or to change sources of funding.

Changes to the budget are made individually through decision packages, which must be approved by the legislature. Decision packages can either change present law or add new proposals approved for funding.

Submission Dates

The director of the Office of Budget and Program Planning (OBPP) is required to submit a preliminary budget reflecting the base budget to the LFD by October 10, and a preliminary budget reflecting a present law base by November 1 in the year before a session. The director is further required to submit an entire preliminary budget by November 15. The LFD provides a detailed and comprehensive analysis of the executive budget, as well as an analysis of other fiscal policy issues.

Base Budget

The current executive budget used actual FY 2008 expenditures as recorded on the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) as the base for determining a present law budget for the 2011 biennium. Certain items were then excluded in order to create a base that reflects only: 1) the cost of ongoing programs or functions approved by the last legislature; and 2) expenditures authorized by the legislature. OBPP and LFD staff reached agreement on virtually all expenditures removed from the base. The LFD analysis provides an explanation within context of any program in which a base difference remains.

Expenditure Base Exclusions

Following is an explanation of each type of expenditure category excluded from the base:

Appropriation Transfers

Section 17-7-301, MCA, allows the Governor to authorize the transfer of funds appropriated for the second year of the biennium to the first year, if the Governor finds that "due to an unforeseen or an unanticipated emergency" the amount appropriated for the first year of the biennium "will be insufficient for the operation and maintenance of the department." Since such transfers do not result from legislative action and may be used for meeting one-time costs, these transfers are excluded from the base. However, if the transfer funds an ongoing cost, OBPP adjusts the present law budgets for the next biennium accordingly.

Budget Amendments

Budget amendments provide temporary authority allowing agencies to spend unanticipated non-general fund revenue received after the legislature has adjourned. This revenue can be used to provide additional services. In accordance with 17-7-402, MCA, budget amendment authority terminates at the end of each biennium and can make no "ascertainable present or future significant commitment for increased general fund support." Expenditures financed through budget amendments are excluded from the base. If an agency wishes to continue an activity financed with a budget amendment in the following biennium, the request must be presented as a new proposal.

One-Time Appropriations

In general, miscellaneous or "cat and dog" appropriations (appropriations made in bills other than the general appropriations act) are considered "one-time" and not continued in the base. The legislature may specify in appropriation acts that an appropriation is not intended to be ongoing and may not be included in the base.

Language Appropriations

In appropriation acts, the legislature may authorize expenditure of funds from a specific source without providing a specific dollar appropriation. Language appropriations are generally used when an agency knows that it will be receiving federal or state special revenue funds (that it is required by statute to spend) but is uncertain as to the amount of those funds. In order to be sanctioned by law as an appropriation, the language must, at least, fix a maximum amount that the appropriations may not exceed. Assuming that ongoing expenditures from these sources are one-time only in nature, the expenditures are excluded from the base.

Non-Budgeted Expenditures

Generally Accepted Accounting Principles (GAAP) require agencies to make accounting entries for depreciation, amortization, and other financial transactions that appear as expenditures, but don't result in the actual expenditure of funds from the state treasury.

Statutory Appropriations

Section 17-7-501, MCA, provides that funds may be appropriated in permanent law rather than through appropriation bills, which are effective for one biennium only. In order for a statutory appropriation to be valid, the statute creating the appropriation must specifically state that it is a statutory appropriation. The statute must then be listed in section 17-7-502, MCA. Examples of statutory appropriations include reimbursements to local governments and debt service payments.

Other Appropriations

This category includes administrative transfers created by OBPP, continuing appropriations from previous years, internal offset adjustments to appropriations, and miscellaneous appropriations.

Entitlement And Formula Funded Programs

Under current state and federal law, certain programs are "entitlement programs," which means that if an individual meets the underlying criteria for qualification, services must be provided (i.e., the person is "entitled" to the service). Projected growth or declines in these programs are funded as part of the present law budget, rather than through new proposals. For example, the legislature has established statutory levels of state support for each child enrolled in Montana public schools. Similarly, federal and state laws require that persons eligible for Medicaid receive specified services or grants. Programs treated as entitlement include K-12 BASE aid, subsidized adoption, foster care, and Medicaid.

Personal Services "Snapshot"

Personal services costs generally comprise around 40 percent of total agency operating expenditures (excluding capital outlay, grants and benefits, and transfers) in any biennium.

The executive budget is based on a "snapshot" of actual salaries for authorized FTE, as they existed in the last pay period of FY 2008. The executive budget includes annualization of the pay increases appropriated in FY 2008 and 2009.

Benefits are added on an individual FTE basis. Workers' Compensation and Unemployment Insurance rates vary from agency to agency, as each agency has a different rate based upon experience.

Vacancy Savings

Vacancy savings is the difference between the full appropriated cost and the actual cost of authorized employee positions during a budget period. Since 1979, the legislature has periodically applied a vacancy savings factor to agency budgets in recognition of the fact that staff turnover and vacancies often result in personal services expenditures lower than the amounts appropriated.

During the 1997 biennium, the legislature included varying vacancy savings rates among selected agencies, and among programs within agencies, in order to fund the executive pay plan. A contingency fund containing $500,000 general fund and $1,000,000 in other funds was included for this purpose.

During the 1999 biennium, the legislature applied a uniform 3 percent vacancy savings rate against all positions in state government, with the exception of those positions in agencies with fewer than 20 FTE. The legislature also assumed that any new positions added via new proposals would not be hired at the very beginning of the fiscal year as a result of the need to recruit and to meet other requirements demanding the expenditure of time. Operating under the assumption that such positions would not be filled for the first three months of the fiscal year, the legislature applied a 25 percent vacancy savings rate in the first year. The legislature also provided $2.3 million general fund and $8.8 million in other funds for the biennium in support of a contingency pool for those agencies that could not meet their vacancy savings targets.

For the 2001 biennium, the legislature adopted a vacancy savings rate of 3 percent on all personal services except insurance. This rate was not applied to agencies with fewer than 20 FTE, elected officials, university system faculty or to direct care workers within the Department of Corrections. The legislature funded a contingency pool of $700,000 from the general fund and $950,000 in other funding for the biennium.

For the 2003 biennium, the legislature enacted a 4 percent vacancy savings rate on all personal services. As in the 2001 biennium, agencies with fewer than 20 FTE as well as university system faculty were exempt. The legislature also included a contingency fund of $1.3 million general fund and $3.0 million from other funds (the legislative branch also received $200,000 general fund) for the biennium to meet potential costs involved for those agencies that do not meet their vacancy savings targets.

For the 2005 biennium, the legislature enacted a 4 percent vacancy savings rate on all personal services. As in the 2003 and 2005 biennia, agencies with fewer than 20 FTE as well as university system faculty are exempt. A contingency fund of $1.5 million general fund and $3.0 million other funds was added to fund potential costs in excess of the appropriation.

In the 2007 biennium, the legislature enacted a 4 percent vacancy savings on all personal services. The following agencies and positions with the same exemptions as the 2005 biennium except that the following were added:

- Montana Highway Patrol
- Student Services and Education Programs in the Montana School for the Deaf and Blind
- Field Services Program in the Child and Family Services Division of the Department of Public Health and Human Services (DPHHS) assessed at a 2 percent rate

In the 2009 biennium, the legislature enacted a 4 percent vacancy savings rate on all personal services. The legislature exempted agencies with 20 or fewer employees, the Judicial and Legislative Branches, in addition to the statutorily exempt highway patrol and game wardens (new in the 2009 biennium).

In the 2011 biennium, the executive is recommending a 7 percent vacancy savings rate, with the same 2009 biennium exceptions, except that direct care workers in the Departments of Corrections and Public Health and Human services are applied a 4 percent rate and the Judicial Branch is applied a 2 percent rate.

Fixed Costs

Agencies are charged fees (called fixed costs) for a variety of services provided by other state agencies. The executive budget includes fixed costs for the following services: Department of Administration (DofA) insurance and bonds (62104), DofA warrant writing fees (62113), DofA payroll service fees (62114), Legislative Auditor audit fees (62122), SABHRS (Statewide Accounting, Budgeting, and Human Resources System) operating costs (62148), DofA ITSD fees (62ITSD), messenger services (62307), DofA rent (62527), capitol complex grounds maintenance (62770), and the statewide cost allocation plan (SWCAP - 62888).

Figure 2 shows the total amounts included in the executive budget for fixed costs.

Figure 2

Fixed Costs
2011 Biennium Executive Budget (in millions)*

Subcommittee/Agency	Function	Total
General Government		
Administration	Insurance and Bonds	$24.6
	Warrant Writing Fees	2.2
	Human Resources	6.1
	ITSD	8.9
	SABHRS Operating	8.9
	Messenger Services	0.6
	Rent - Buildings	21.6
	Grounds Maintenance	1.0
	Workers Compensation**	0.8
Legislative Audit Division	Audit Fees	3.6
Various	Statewide Cost Allocation	8.3
Total		$86.6

*All funds, including funds not appropriated in HB 2

**Proposed by the executive

Insurance and Bonds

The Risk Management and Tort Defense Division of the DofA collects premiums from state agencies for: 1) administration of the self-insurance program, which provides state agencies with general liability and automobile coverage; and 2) purchase of commercial policies for state agency property, aircraft, and to protect against the potential consequences of other risks. Costs are allocated to agencies based upon actual loss experience and inherent exposure.

Warrant Writing Fees

DofA provides warrant writing and direct deposit services for agency financial transactions. The costs of these services are allocated to agencies based upon actual utilization of the various types of transactions in the three previous years.

Payroll Services (Human Resources Information System)

The State Payroll Program in DofA prepares and distributes payroll for all state agencies. Costs of these services are allocated to agencies based upon the number of paychecks issued for each agency per year.

Workers Compensation

The 2007 Legislature funded, as a one-time-only, a Workers Compensation Management Program. In the 2011 biennium, the executive is proposing making the program permanent, and funding it with an indirect charge to all agencies based upon the average number of payroll warrants issued per pay period.

Audit Fees

The legislative Audit Division charges agencies for the costs of financial compliance audits. These charges are included in agency budgets as biennial appropriations and allocated according to the estimated number of billable hours for each agency audit.

SABHRS Operations Unit

This unit provides all operational support for the Statewide Accounting, Budget, and Human Resources System (SABHRS). Costs were allocated in the executive budget based upon the number of full-time equivalent employees.

Information Technology Services

The Information Technology Services Division (ITSD) of DofA is changing to an activity-based budgeting system that charges agencies for the information technology services in a way that more closely relates to the actual services used by each individual user. The 2011 biennium is a transition period in which this fixed cost category will begin to allocate the costs to agencies through a methodology that will more broadly incorporate data, voice, video, and computer application and processing services in the calculation of costs.

Messenger Service

The Mail and Distribution Program in DofA charges state agencies for interagency mail pickup and delivery services. Costs for these services are allocated to agencies based upon the volume of mail generated by, and number of daily deliveries to, each agency.

Rent

The General Services Division (GSD) of DofA charges rent to state agencies for costs relative to maintaining office and warehouse space in the capitol complex buildings managed by GSD. Included in the charges are utility, security and janitorial services, mechanical maintenance, and minor maintenance costs including such items as painting, lighting and carpeting. Warehouse costs are allocated to agencies based upon the amount of square footage of office warehouse space occupied; a fixed rate per square foot is used.

Grounds Maintenance

The Department of Administration charges state agencies for grounds maintenance and snow removal at capitol complex buildings. Costs of these services are allocated based upon the square footage of office space occupied by a given agency.

Statewide/State Fund Cost Allocation Plan (SWCAP/SFCAP)

There are two state cost allocation plan components that are directly billed to agencies. Cost allocations are made to collect funds for the support of those state government operating costs that cannot be easily identified with particular funding sources. Collections are deposited to the general fund to offset a portion of those costs, which would otherwise be supported entirely with general fund. The two components are: 1) SFCAP (the state fund costs allocation plan), and 2) SWCAP (the statewide cost allocation plan). SFCAP is a direct charge to offset costs. SWCAP is based upon a rate negotiated by DofA each year with the state’s federal cognizant agency (Health and Human Services). Among the programs for which operating costs are partially recovered through cost allocation plan collections are: 1) Procurement and Printing, State Personnel Division, and Accounting/Management Support in DofA; 2) a use charge on construction and renovation of certain state buildings; and 3) budget management services in the Office of Budget and Program Planning in the Governor's Office. Costs are allocated to agencies based upon the following: a) Procurement and Printing – depending upon the service, either requisitions processed, total operating costs, or equal allocations; b) State Personnel - the number of FTE authorized and classified, and the number of union covered employees; c) Accounting and Management Support - the number of accounting and cash transactions; and d) OBPP - the number of budget change documents, budget journal entries, executive planning process requests, and funding sources. Construction and renovation of certain state buildings is based on a user charge of 2 percent of the cost.